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Will Dodd-Frank's Diversity Mandates Go Far Enough?

Law360, New York (April 11, 2014, 6:46 PM ET) -- The lack of employment diversity in the financial services sector has been well documented. According to an April 2013 report of the U.S. Government Accountability Office, in the wake of the financial crisis, the number of minorities and women in management in the financial services industry, its regulating agencies and the Federal Reserve banks has not substantially changed from 2007 to 2011. Women represent approximately 30 percent of senior management at financial firms and 36 percent at financial regulators. The number of minorities in senior management positions is even lower with only approximately 11 percent representation at financial firms and 17 percent at their regulators.[1]

Congress has acted in an attempt to remedy historical practice. On July 10, 2010, in response to the financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was signed into law. Section 342, an often overlooked provision of the act, was adopted to help correct racial and gender imbalances at financial institutions and their regulators by prescribing inclusion requirements at the specified U.S. government agencies that regulate the financial services sector,[2] entities that contract with the agencies and the private businesses they regulate.

Both Section 342 and the standards proposed by certain of the regulated agencies focus on transparency and awareness of diversity policies within the agencies, but generally do not prescribe quotas, mandate specific actions or impose penalties. While this law is a step in the right direction to achieve diversity in the financial services sector, the ultimate impact of Section 342 remains to be seen.

Section 342

Pursuant to Section 342, each agency has established an Office of Minority and Women Inclusion, or OMWI. The OMWIs and their appointed directors are charged with:

- developing diversity standards for the agency's workforce;
- increasing participation of minority- and female-owned businesses in the agency's programs and contracts; and
- assessing the diversity policies and practices of the financial entities regulated by the agency.

Each OMWI is required to submit an annual report to Congress outlining the agency's actions under Section 342. The report must indicate the percentage of total contracting fees paid to minority and women contractors and identify the successes and challenges faced with respect to diversity outreach.

Diversity in the Agencies' Workforces. The agencies must take "affirmative steps" to seek diversity within their own workforces at all levels. These steps must, at a minimum, include recruiting at colleges that have historically had a high percentage of minority and female students enrolled, sponsoring and recruiting from job fairs in urban communities, and advertising employment opportunities in publications targeted at minorities and women.

Diversity and Inclusion in the Agencies' Business Activities. Each agency must also develop and implement standards and procedures to ensure the fair inclusion and utilization of minorities and women (and businesses owned by these groups) in all of their business activities. This mandate has expansive reach and applies to all agency contracts of any kind, including those with most financial service entities and law firms.

The agencies are also required to adopt standards and procedures to determine whether a contractor has made a "good faith effort" to include minorities and women in its workforce. The penalties for a contractor's noncompliance are steep and can include termination of the contract or a referral to the office of the Federal Contract Compliance Programs of the U.S. Department of Labor.

Diversity in the Agencies' Regulated Entities. Pursuant to Section 342, six of the agencies[3] have proposed joint standards to provide guidance on the scope of the required assessment. The proposed standards do not mandate an examination or supervisory assessment process, but instead focus on self assessment and public disclosure.

A model assessment process would include a quantitative and qualitative self evaluation of the entities' diversity and inclusion policies and a voluntary report of the findings to the regulating agency. Further, the entity would include information regarding its efforts to comply with the proposed standards on its public website, annual reports and other disclosure documents.

The proposed standards cover the following four key categories of assessment to be implemented in a manner reflective of the entity's size and other characteristics.

- ***Organizational Commitment to Diversity and Inclusion.*** A diversity and inclusion policy should be approved and supported by senior management and the board, which should receive regular progress reports. A senior level officer who oversees and directs diversity efforts should be appointed and should ensure that there is regular equal employment and diversity and inclusion education and training. Finally, the entity must take proactive steps to promote a diverse pool of candidates for senior leadership and board positions.

- ***Workforce Profile and Employment Practices.*** Management should be held accountable for the success of diversity and inclusion efforts. Entities should adopt metrics to evaluate and assess workforce diversity and inclusion efforts, in all areas of employment across all levels of the organization. Policies and practices that create diverse applicant pools for both internal and external opportunities should be implemented, including (1) participation in conferences and other events and (2) outreach to organizations and educational institutions primarily aimed at serving minority and female populations.

- ***Procurement and Business Practices — Supplier Diversity.*** Steps that can be taken in this regard include adopting (1) a supplier diversity policy providing for a fair opportunity for minority- and women-owned businesses to compete in the procurement of business and services, (2) procedures to evaluate and assess supplier diversity, and (3) practices to promote a diverse supplier pool, including publicizing procurement opportunities and outreach to minorities and women.

- ***Practices to Promote Transparency of Organizational Diversity and Inclusion.*** Transparency in an entity's diversity and inclusion program is crucial to attaining the objectives of Section 342. Information on the entity's commitment to diversity and inclusion, its plans for achieving its goals, its progress against those goals and the metrics it uses to measure success should be made available to the public on the entity's website and annual shareholder reports.

Section 342 expressly provides that it should not be construed to impose any requirement on, or otherwise affect the lending policies and practices of, any regulated entity or require any specific action based on the findings of an assessment.

Accordingly, the proposed standards do not impose consequences if an entity does not implement appropriate diversity and inclusion policies. They simply state that the agency will use the information as a resource for carrying out their diversity and inclusion responsibilities. The comment period on the proposed standards closed on Feb. 7, 2014, and the agencies received more than 45 comments.

Our Thoughts

We applaud the goals and purpose of Section 342 and the proposed standards. Greater diversity and inclusion will promote stronger, more effective and more innovative businesses, and we urge all U.S. entities, not just those in the financial services industry, to foster diversity and inclusion in their workforce and business dealings.

However, while the proposed standards may impact employment and recruiting practices, it is unclear whether they, or Section 342 itself, go far enough and will actually lead to greater diversity and inclusion at financial services institutions.

To begin with, there is no enforcement mechanism under Section 342, and the proposed standards do not mandate reporting, disclosure or other specific actions. The rationale for this approach is that public awareness and transparency will drive changes in practice.

Public disclosures have often resulted in significant changes to public entity policies. For instance, in recent years, the U.S. Securities and Exchange Commission has significantly overhauled its compensation disclosure rules. While the commission did not regulate the amount or form of compensation, the enhanced disclosures permitted the public to better understand an issuer's compensation programs and to use their voting power and the press to effectuate change in compensation practices.

While this is theoretically translatable to diversity policies, it will not necessarily drive change in the financial services industry, where there has been significant pressure to create a more diverse environment for a number of years.
Also, many financial institutions have already implemented significant programs and policies that will

likely satisfy the proposed standards.

For example, to ensure compliance with employment laws, most entities maintain equal opportunity policies and have adopted procedures to handle discrimination and harassment complaints (including anti-retaliation policies). Many also gather statistical data regarding the gender and racial demographics of their employee populations and applicant pools in connection with the preparation of Forms EEO-1 and affirmative action plans.

Further, forming an office of diversity and employing a senior diversity officer has become commonplace, particularly at large public companies. Finally, many entities actively recruit minority and women candidates and maintain outreach and mentoring programs to foster racial and gender diversity in the leadership ranks.[4]

Unfortunately, these steps have not significantly altered the demographics at financial services entities to date, particularly at executive and senior-level positions. According to the U.S. Equal Employment Opportunity Commission, in 2012, while white men account for 65 percent of the executive and senior management populations in the financial services industry, minorities and women account for only 10 percent and 29 percent of these positions, respectively.[5]

In contrast to Section 342, the European Union has introduced diversity initiatives with more concrete obligations. The Capital Requirements Directive IV requires relevant financial institutions to set a target for representation of the underrepresented gender for its board and to prepare a policy on how to achieve that target.

Proposed EU legislation would require all publicly listed companies to ensure that, by 2020, at least 40 percent of nonexecutive directors are female. In addition, by 2020, companies would be required to meet self-regulated targets regarding the representation of both genders among executives. Finally, many EU member states, including Norway, Spain, Italy and France, have introduced country-specific gender diversity quotas for boards of directors.

U.S. Rep. Maxine Waters of California, the author of Section 342, noted that “many industries lack the inclusion and participation” of minorities and women, with none “more egregiously ... than the financial services sector.” Section 342 provides the opportunity to “not only give oversight to diversity, but to help the [a]gencies understand how to do outreach [and] how to appeal to different communities.”

In order to achieve a meaningful change, financial service entities in the United States can seize this opportunity and make inclusion and diversity a high-profile priority in both words and actions, and the regulators should mandate a clear set of guidelines and consequences for failure to comply. It remains to be seen whether Section 342 and the final standards as adopted will bring us closer to this result.

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[1] Unites States Government Accountability Office, Report to the Ranking Member, Committee on Financial Services, U.S. House of Representatives, Diversity Management: Trends and Practices in the Financial Services Industry and Agencies after the Recent Financial Crisis, April 2013. The report notes that there is an increase in both minorities and women in first- and mid-level management positions, which may create a pipeline for increased representation in senior management positions in the future.

[2] The agencies include: (1) the Office of the Comptroller of the Currency, (2) the Board of Governors of the Federal Reserve System, (3) the Federal Deposit Insurance Corporation, (4) the National Credit Union Administration, (5) the Bureau of Consumer Financial Protection, (6) the U.S. Securities and Exchange Commission, (7) the Departmental Offices of the Department of the Treasury, (8) the Federal Reserve Banks and (9) the Federal Housing Finance Agency.

[3] The U.S. Department of the Treasury, the Federal Reserve Banks and the Federal Housing Finance Agency did not participate in the joint policy statement.

[4] A number of the comment letters assert that the information contained in these reports should be sufficient for the agencies to assess diversity and that imposing additional obligations will further burden the institutions with little positive effect.

[5] 2012 Job Patterns for Minorities and Women in Private Industry (EEO-1), 2012 EEO-1 National Aggregate Report by NAICS-2 Code (Finance and Insurance), (2012), available at http://www1.eeoc.gov/eeoc/statistics/employment/jobpat-eeo1/2012/index.cfm#centercol.
